

**STATE AND LOCAL GOVERNMENT FUNDING OF  
HEALTH AND RETIREMENT BENEFITS FOR  
EMPLOYEES: CURRENT PROBLEMS AND POSSIBLE  
SOLUTIONS WITH CALIFORNIA HEALTH BENEFITS  
AS AN EXAMPLE**

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## INTRODUCTION

Government employee health and retirement benefits have come under a likely unprecedented critique, some may say attack, during the difficult economic times, particularly for state and local governments, during the beginning of the second decade of the twenty-first century. Some suggested changes are more incremental than others. The City of San Diego is putting a measure before voters to offer new city employees 401(k)'s rather than defined benefit pensions.<sup>1</sup> The voters in the City of Carlsbad, a San Diego suburb, have already approved an initiative requiring future city employees' benefits to be approved by voters. Carlsbad had already implemented a two-tiered pension system in which new employees receive significantly lower retirement benefits.<sup>2</sup> The University of California Board of Regents ("UC Regents") has recently voted to increase employee and employer contributions to the retirement plan as well as to raise the retirement age for future university employees and to require those employees to pay more for their health care benefits.<sup>3</sup> The UC Regents also has been resisting an effort to raise the limit on compensation upon which pensions are calculated.<sup>4</sup> Other efforts have been to restrict the ability of employees to add to their pensions, for example, by buying additional years to add to the pension formula (normally, for example, years of services times final salary year or three year compensation times 1.2% to 3%).<sup>5</sup>

Some attempts at curtailing public employees' retirement and health benefits are likely more radical. The California Little Hoover

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1. Craig Gustafson, *Public Safety Pensions Could Be On The Line Decision On Pensions May Go To Voters*, SAN DIEGO UNION-TRIB., Feb. 26, 2011, at A1.

2. See Aaron Burgin, *Carlsbad Pension Reform Initiative Wins*, SIGNONSANDIEGO.COM (Nov. 2, 2010, 8:19 PM), <http://www.signonsandiego.com/news/2010/nov/02/carlsbad-pension-reform-initiative-leading-in-early>.

3. See Terence Chea, *UC Regents Vote to Raise Pension Contributions*, SIGNONSANDIEGO.COM (Sep. 16, 2010, 11:44 AM), <http://web.signonsandiego.com/news/2010/sep/16/uc-regents-vote-to-raise-pension-contributions>; Terence Chea, *UC Raises Retirement Age for University Employees*, SIGNONSANDIEGO.COM (Dec. 13, 2010, 4:39 PM), <http://web.signonsandiego.com/news/2010/dec/13/uc-raises-retirement-age-for-university-employees>.

4. The Associated Press, *Top Univ. of Calif. Execs. Seek Big Pension Boost*, SIGNONSANDIEGO.COM (Dec. 29, 2010, 12:22 PM), <http://web.signonsandiego.com/news/2010/dec/29/top-univ-of-calif-execs-seek-big-pension-boost>.

5. See Anthony York & Jack Dolan, *California State Employees Take Advantage of Pension Perk*, L.A. TIMES, Feb. 16, 2011, available at <http://articles.latimes.com/2011/feb/16/local/la-me-pensions-airtime-20110216>.

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Commission, an independent group including five governor-appointed citizens, four legislature-appointed citizens, two state senators, and two state representatives,<sup>6</sup> recently recommended “freez[ing] pension benefits for current state and local government workers” and moving to a “hybrid model” that would include a 401(k).<sup>7</sup> The Commission also recommended a two-tiered system with lesser benefits for new employees, increasing contributions from government workers, preventing workers from increasing pay in final year of service, capping annual salary for calculating pension benefits, and increasing minimum retirement age, among other suggestions.<sup>8</sup> The State of Wisconsin passed legislation to deny collective bargaining to government employees for benefits.<sup>9</sup> Finally, the City of San Diego successfully litigated against the city police union to be able to renegotiate future health benefits of retirees.<sup>10</sup>

This article will first examine the various estimated costs for future retirement and health benefits of state and local government employees. Secondly, the article will evaluate some of the suggested reductions in retiree health benefits and the limitations on such reductions, particularly in the context of the laws of California as an example. Finally, the article will examine the health and retirement benefits of state and local government employees within the larger context of the societal stake in such benefits.

## I. COSTS OF STATE AND LOCAL GOVERNMENT EMPLOYEES’ PENSIONS AND HEALTH BENEFITS

### A. *The Total Bill*

As indicated previously, the increasing cost to states and municipalities of both pension and health care has become a focal point for commentaries and newspaper articles as well as legislative calls for

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6. *Commissioners*, LITTLE HOOVER COMMISSION, <http://www.lhc.ca.gov/about/commis.html> (last visited Feb. 13, 2012).

7. Judy Lin, *Commission: Freeze Pensions for Calif. Workers*, SIGNONSANDIEGO.COM (Feb. 24, 2011, 4:35 PM), <http://www.signonsandeigo.com/news/2011/feb/24/commission-freeze-pensions-for-calif-workers>; see also Marisa Lagos, *Commission Urges Major Overhaul of State Pensions*, THE S.F. CHRON., Feb. 25, 2011, at C8.

8. Lin, *supra* note 7.

9. Mark Trumbull, *Did Wisconsin Senate Choose Nuclear Option in Collective-Bargaining Fight?*, THE CHRISTIAN SCI. MONITOR (Mar. 9, 2011), <http://www.csmonitor.com/USA/Politics/2011/0309/Did-Wisconsin-Senate-choose-nuclear-option-in-collective-bargaining-fight>.

10. *San Diego Police Officers Ass’n v. San Diego City Emps. Ret. Sys.*, 568 F.3d 725, 740 (9th Cir. 2009).

reform. Part of the problem likely resulted from the stock market performance in late 2007 through early 2009, compounded by the failure of both states and municipalities to meet the required funding of their pension obligations, and the simple fact that many states did little to set aside funds for funding the future health care commitments made to retiring employees. In many of the cases, these increasing obligations were met by a pay-as-you-go philosophy, funding the future obligations as they came up out of current revenue.<sup>11</sup> In the current recession, decreasing property values, decreasing retail sales, and increasing unemployment have resulted in decreasing property tax, sales tax, and income tax revenues for the same states and municipalities.

This gap between benefit obligations and pension funding for states and municipalities is becoming wider as the baby boom workforce ages and approaches retirement.<sup>12</sup> In the past, states and municipalities readily increased future benefits rather than offer current compensation increases, and in some cases offered both, when the state and local coffers were full.<sup>13</sup> For the fifty states as a group, the shortfall is \$1.26 trillion in fiscal year 2009, resulted in a twenty-six percent increase in one year, according to the Pew Center Report released in April 2011.<sup>14</sup> These figures may be relatively conservative as they are predicated on calculations provided by the various states.<sup>15</sup> Unlike private pension assumptions based on past revenues, the returns of public pension funds are based on what the states or municipalities think they will receive, not on what they have been able to achieve. This is done as a method of “smoothing” results.<sup>16</sup> The most comprehensive analysis to date finds “[s]tate pension plans represented slightly more than half of this shortfall, with \$2.28 trillion stowed away to cover \$2.94 trillion in long-term liabilities—leaving about a \$660 billion gap . . . . Retiree health care and other [non-pension] benefits accounted

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11. THE PEW CENTER ON THE STATES, THE TRILLION DOLLAR GAP: UNDERFUNDED STATE RETIREMENT SYSTEMS AND THE ROADS TO REFORM 5 (Feb. 2010), available at [http://downloads.pewcenteronthestates.org/The\\_Trillion\\_Dollar\\_Gap\\_final.pdf](http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf); see also Haiwei Chen & Jim Estes, *Planning for Defined Pension Plans in Today's Environment*, J. FIN. SERVICE PROFS. (May 2007), available at <http://alpha-wealth.com/resources/publications/Planning-%20for-Pension-JOFSP-May%2007.pdf>.

12. THE PEW CENTER ON THE STATES, *supra* note 11, at 7.

13. See generally THE PEW CENTER ON THE STATES, BEYOND CALIFORNIA: STATES IN FISCAL PERIL (Nov. 2009), available at [http://www.pewcenteronthestates.org/report\\_detail.aspx?id=56044](http://www.pewcenteronthestates.org/report_detail.aspx?id=56044).

14. *The Widening Gap: The Great Recession's Impact on State Pension and Retiree Health Care Costs*, PEW CENTER ON THE STATES 1 (Apr. 2011), available at [http://www.pewcenteronthestates.org/uploadedFiles/Pew\\_pensions\\_retiree\\_benefits.pdf](http://www.pewcenteronthestates.org/uploadedFiles/Pew_pensions_retiree_benefits.pdf).

15. See *id.* at 9.

16. *Id.* at 4-5.

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for the remaining \$607 billion . . . .”<sup>17</sup> States have amassed \$638 billion in non-pension liabilities, but saved just \$31 billion to pay for them—”slightly less than five percent of the total cost.”<sup>18</sup> About thirty-one states are funded below eighty percent based on this measure of the liability.<sup>19</sup>

Meanwhile, almost unnoticed until the Governmental Accounting Standard Board’s statement 45 (“GASB 45”), state and local governments face a total 2009 shortfall of up to \$1.26 trillion in their health care plan commitments to retirees or approximately \$135,000 for each state or local employee.<sup>20</sup> GASB 45 requires that states and municipalities, for fiscal periods beginning after December 15, 2006, report the projected cost of retiree health care benefits as debt.<sup>21</sup> This reporting of the benefits is unlike the previous reporting in which governments were not required to state the cost of benefits until after employees retired, and then only on an as paid basis. This massive figure will be increasing as more and more retirees reach the “golden years” and take advantage of the commitments made during their years working for state and municipal governments. The Pew Center reported that at least nineteen states have no reserve (savings) for their post-retirement healthcare costs and are going on a “pay-as-you-go basis.”<sup>22</sup> This entire issue is further exasperated by the performance of the stock market in 2008, which resulted in a precipitous drop in the assets of municipalities and pension funds available. The Pew Center report estimates, when applying the risk-adjusted rate, the unfunded liability for pensions alone amounts up to between \$1.8 and \$2.4 trillion.<sup>23</sup> This represents, as of May 6, 2011, up to 16.8% of all the total public debt outstanding of the United States of America and 17.3% of the 2006 U.S. Gross Domestic Product in the first quarter of 2011.<sup>24</sup>

While not all municipalities are as dramatically affected, either because they have few benefits or because they owe nothing at all, like Ohio and California’s Santa Clara County which started funding these

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17. *Id.* at 1.

18. *Id.* at 1.

19. *The Widening Gap*, *supra* note 14, at 2.

20. Danielle Andrus, *States’ Pensions, Health Care Funding Shortfalls Top \$1 Trillion*, ADVISORONE (Apr. 26, 2011), <http://www.advisorone.com/2011/04/26/states-pension-health-care-funding-shortfalls-top>.

21. THE PEW CENTER ON THE STATES, *supra* note 11, at 43.

22. *The Widening Gap*, *supra* note 14, at 5.

23. *Id.* at 2.

24. *Id.*

obligations years ago, the vast majority are likely in trouble.<sup>25</sup> Some of the states will likely face very large deficit forecasts. West Virginia currently anticipates \$8 billion for current retirees and is looking at \$50 billion in 2040; New York State, including all cities and counties, is facing a total of \$250 billion over the next thirty years; the state of Maryland is facing \$20.4 billion, up from estimates of \$3 to \$6 billion several years earlier.<sup>26</sup> The big unknown is the effect that these liabilities will have on the bond and credit ratings of municipalities—that is, not whether or not the liabilities will impact these ratings but rather to what degree. In the state of California, for instance, whose own unfunded liability is \$59.9 billion,<sup>27</sup> while Riverside County has an unfunded liability of more than \$700 million.<sup>28</sup> This problem will only compound as the trend of police, teachers, and firefighters to take early retirement continues and the annually increasing cost of healthcare remains in the double digits.<sup>29</sup>

Pension funding levels for state and municipal governments have dramatically declined over the last ten years.<sup>30</sup> This is a direct result of deliberate underfunding by state and municipal governments and the losses of the pension funds as they take increasing risk to make up for prior losses.<sup>31</sup> The downturn in 2008 had a serious effect on pensions and the funds available to pay them. Even in 2000, when most pension systems were considered “well-funded,” state and municipal governments were required to contribute an additional \$27 billion to pay for promised benefits.<sup>32</sup>

By 2004, following the 2001 recession, their annual payment for state-run pensions should have increased to \$42 billion . . . . [In total], states and participating localities should have paid about \$108 billion in fiscal year 2008 to adequately fund their public sector retirement benefit systems. Instead, they paid only about \$72 billion.<sup>33</sup>

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25. See, e.g., Nanette Byrnes, *A Shock to the System*, BUS. WK., Dec. 4, 2006, at 102, available at [http://www.businessweek.com/magazine/content/06\\_49/b4012091.htm](http://www.businessweek.com/magazine/content/06_49/b4012091.htm).

26. *Id.*

27. *Unfunded Liability for Retiree Health Care Hits Nearly \$60B*, CAL. HEALTHLINE (Mar. 15, 2011), [www.Californiahealthline.org/2011/315/article-unfunded-liability-for-retirees-health](http://www.Californiahealthline.org/2011/315/article-unfunded-liability-for-retirees-health).

28. Tim O’Leary, *Riverside County Supervisors Seek Support for Measure Aimed at Curbing ‘Unsustainable’ Pension Costs*, VALLEY NEWS (Sept. 24, 2010), <http://www.myvalleynews.com/story/51101>.

29. Byrnes, *supra* note 25.

30. THE PEW CENTER ON THE STATES, *supra* note 11, at 1.

31. *See id.*

32. *See id.*

33. *Id.* at 1-2.

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In 2008, many states lost more than ten percent of their money available to meet pension obligations on their investments, ranging from Pennsylvania with a loss of 28.7% to 13.1% for Georgia.<sup>34</sup>

In 2000, just over fifty percent of the states had a fully-funded pension program.<sup>35</sup> In 2006, only six had fully-funded programs and, by 2008, only four state programs were fully funded.<sup>36</sup> In 2008, twenty-one states were under the eighty percent funding level, and, in eight states, more than thirty-three percent remained unfunded.<sup>37</sup> Two states, Illinois and Kansas, were under sixty percent, with Illinois being the worst with fifty-four percent unfunded at \$54 billion.<sup>38</sup> All of these problems, reflected in the shortages, are compounded given the rate of return, as previously stated, used by state and municipal governments are predicated on what they expect to receive, not what they have achieved in the past. This enables them to declare a more aggressive return to help offset the deficits. Not all states fall into this category. As can be seen from Exhibit 1, the unfunded liabilities for health care and other non-pension benefits by state are very significant.<sup>39</sup> Only four states are less than fifty percent unfunded, none are fully funded, and nineteen are one hundred percent unfunded for their current liabilities for pension and health care promised benefits.<sup>40</sup> Four states (Arizona, Alaska, North Dakota, and Maine) met their required funding for the current term, and every state has unfunded liabilities.<sup>41</sup> With decreasing revenues and until the housing market recovers and property taxes, new home permit fees, sales taxes, and other related fees begin to return to a normal level, the states and municipalities are likely facing decreased revenues and increasing expenses. These government entities are faced with the prospect of having to increase taxes and cut critical services in order to close the increasing shortfall.

According to Joshua Rauh, a professor at the Kellogg School of Management, there are eleven states that are within ten years and seven are within eight years of defaulting on their pension obligations.<sup>42</sup> He

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34. *See id.* at 7.

35. THE PEW CENTER ON THE STATES, *supra* note 11, at 16.

36. *Id.*

37. *Id.* at 16, 17.

38. *Id.* at 17.

39. THE PEW CENTER ON THE STATES, *supra* note 11, at 6.

40. *Id.* at 5.

41. *Id.*

42. Joshua D. Rauh, *Are State Public Pensions Sustainable? Why the Federal Government Should Worry About State Pension Liabilities*, 63 NAT'L TAX J. 585, 596 (2010), available at <http://ssrn.com/abstract=1596679>.

feels that given their present obligations, Kentucky, New Hampshire, Kansas, and Colorado state pension funds will run out of money by 2022.<sup>43</sup> Further, the states of Oklahoma, Louisiana, and Hawaii will similarly exhaust their state pension funds by 2020.<sup>44</sup> He further asserts that New Jersey, Indiana, and Connecticut state pension funds will be exhausted by 2019 and the first to run out will be the pension fund for the state of Illinois in 2018.<sup>45</sup>

Exhibit 1  
State Retiree Health Care and Other Non-Pension Benefits<sup>46</sup>  
Figures are in thousands

State	Latest Liability	Latest Unfunded Liability	Latest Required Contribution	Latest Actual Contribution	Percent of Required	Percent of Unfunded	Percent of Liability Unfunded
Alabama	\$15,950,194	\$15,549,411	\$1,313,998	\$1,107,831	84.30%	7.10%	97.50%
Alaska	9,146,629	4,032,052	558,041	600,003	107.50%	14.90%	44.10%
Arizona	2,332,720	808,818	146,198	146,198	100%	18.10%	34.80%
Arkansas	1,822,241	1,822,241	170,177	38,119	22.40%	2.10%	100%
California	62,466,000	62,463,000	5,178,789	1,585,295	30.60%	2.50%	100%
Colorado	1,385,954	1,127,179	81,523	25,877	31.70%	2.30%	81.30%
Connecticut	26,018,800	26,018,800	1,718,862	484,467	28.20%	1.90%	100%
Delaware	5,489,000	5,409,600	464,600	176,548	38%	3.30%	98.60%
Florida	3,081,834	3,081,834	200,973	87,825	43.70%	2.80%	100%
Georgia	19,100,171	18,322,123	1,583,008	422,157	26.70%	2.30%	95.90%
Hawaii	10,791,300	10,791,300	822,454	299,466	36.40%	2.80%	100%
Idaho	493,746	489,421	45,494	17,695	38.90%	3.60%	99.10%
Illinois	40,022,030	39,946,678	1,192,336	159,751	13.40%	0.40%	99.80%
Indiana	442,268	442,268	45,963	10,218	22.20%	2.30%	100%
Iowa	404,300	404,300	42,991	16,613	38.60%	4.10%	100%
Kansas	316,640	316,640	16,039	5,105	31.80%	1.60%	100%
Kentucky	13,008,572	11,660,245	1,051,372	259,912	24.70%	2.20%	89.60%

43. *Id.*

44. *Id.*

45. *Id.*

46. THE PEW CENTER ON THE STATES, *supra* note 11, at 6.



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Louisiana	12,542,953	12,542,953	1,168,087	269,841	23.10%	2.20%	100%
Maine	4,399,800	4,347,702	164,045	196,053	119.50%	4.50%	98.80%
Maryland	14,842,304	14,723,420	1,086,240	390,319	35.90%	2.70%	99.20%
Mass.	15,305,100	15,031,600	838,700	701,992	83.70%	4.70%	98.20%
Michigan	40,668,800	39,878,500	3,946,416	1,207,746	30.60%	3.00%	98.10%
Minnesota	1,011,400	1,011,400	109,982	46,677	42.40%	4.60%	100%
Mississippi	570,248	570,248	43,627	0	0%	0%	100%
Missouri	2,867,472	2,851,826	262,215	151,629	57.80%	5.30%	99.50%
Montana	631,918	631,918	58,883	0	0%	0%	100%
Nebraska	Does not calculate its liability for retiree health care and other benefits						
Nevada	2,211,439	2,211,439	287,217	59,167	20.60%	2.70%	100%
New Hampshire	3,229,375	3,054,188	268,848	112,038	41.70%	3.70%	94.60%
New Jersey	68,900,000	68,900,000	5,022,100	1,249,500	24.90%	1.80%	100%
New Mexico	3,116,916	2,946,290	286,538	92,121	32.10%	0%	94.50%
New York	56,286,000	56,286,000	4,133,000	1,264,000	30.60%	2.20%	100%
North Carolina	29,364,734	28,741,560	2,459,469	597,176	24.30%	2.10%	97.90%
North Dakota	123,776	81,276	6,085	6,450	106%	7.90%	65.70%
Ohio	43,759,606	27,025,738	2,717,364	855,937	31.50%	3.20%	61.80%
Oklahoma	359,800	359,800	48,200	0	0%	0%	100%
Oregon	868,393	609,793	67,126	45,385	67.60%	7.40%	70.20%
Penn.	10,048,600	9,956,800	823,500	745,600	90.50%	7.50%	99.10%
Rhode Island	788,189	788,189	46,125	28,378	61.50%	3.60%	100%
South Carolina	8,791,792	8,638,076	762,340	241,383	31.70%	2.80%	98.30%
South Dakota	76,406	76,406	9,429	3,505	37.20%	4.60%	100%
Tennessee	1,746,879	1,746,879	167,787	63,140	37.60%	3.60%	100%
Texas	29,340,584	28,611,584	2,236,952	592,507	26.50%	2.10%	97.50%
Utah	677,499	672,843	53,969	53,289	98.70%	7.90%	99.30%
Vermont	1,618,245	1,614,581	107,506	17,776	16.50%	1.10%	99.80%
Virginia	3,963,000	2,621,000	541,163	446,321	82.50%	17.00%	66.10%
Washington	7,901,610	7,901,610	682,797	156,294	22.90%	2.00%	100%
West Virginia	6,362,640	6,108,398	174,842	143,582	82.10%	2.40%	96.00%

Wisconsin	2,237,204	1,700,396	205,116	90,134	43.90%	5.30%	76.00%
Wyoming	174,161	174,161	19,292	7,324	38.00%	4.20%	100%

### B. Comparing to the Private Sector

Unlike the public sector, the private sector saw the trend in health care costs and the long-term effect on their profits and adjusted accordingly. The number of Americans age sixty-five and over is expected to double by 2030, according to the United States Census Bureau.<sup>47</sup> By spring 2030, seventy-two million, or one out of every five Americans, will be sixty-five and over.<sup>48</sup> These numbers will likely, in and of themselves, cause a strain on the U.S. health care system and further serve to exasperate the pressure on all sectors to fund this benefit. The funding required may well prove to be daunting. Fidelity Investments recently estimated the average sixty-five year old couple will need \$230,000 to cover medical costs beyond Medicare coverage during retirement (excluding over-the-counter medicines, dental care, and long-term care).<sup>49</sup> A 2009 analysis by the Employee Benefit Research Institute found that a male retiree would require a savings of somewhere between \$134,000 and \$378,000 to be ninety percent certain that he could cover health insurance premiums and out-of-pocket expenses during retirement, depending on life span and increases in the cost of health care.<sup>50</sup>

In 1988, nearly seventy percent of the large publicly held and private employers offered retiree's health benefits.<sup>51</sup> By the year 2005 this number was down to thirty-three percent, while eighty-four percent of state and local governments continued to offer retiree's health care benefits, according to a Kaiser Foundation study of 2000 employers.<sup>52</sup> In 2007, private sector employers paid eighty-four percent of the costs

47. *Americans Over 65 to Double by 2030*, WEBMD (Feb. 13, 2003), <http://www.webmd.com/health-aging/news/20030213/americans-over-65-to-double-by-2030>.

48. THE PEW CENTER ON THE STATES, *supra* note 11, at 31.

49. *Fidelity Investments Estimates Health Care Costs for Couples Retiring in 2011 Will Drop to \$230k in One-Time Reduction*, FIDELITY INVESTMENTS (March 31, 2011), <http://www.fidelity.com/inside-fidelity/individual-investing/2011-rhccce>.

50. Paul Fronstin et al., *Savings Needed for Health Expenses in Retirement: An Examination of Persons Ages 55 and 65 in 2009*, EMP. BENEFIT RES. INST., June 2009, at 2, 5, available at [http://www.ebri.org/pdf/notespdf/EBRI\\_Notes\\_06-June09.HlthSvg-RetFndg1.pdf](http://www.ebri.org/pdf/notespdf/EBRI_Notes_06-June09.HlthSvg-RetFndg1.pdf).

51. Gilbert Chan, *Governments Wrestle with Retiree Costs: New Accounting Rules Put Pressure on Public Agencies*, THE SACRAMENTO BEE, Apr. 2, 2006, at A1.

52. *Id.*

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of the employer provided health care for single workers and seventy-two percent of the costs for family coverage.<sup>53</sup> Today, only one in five companies offer health benefits to retirees over sixty-five.<sup>54</sup> While costs have mitigated somewhat in the last three years, the total increase over the last five years has been in excess of sixty percent, according to the Towers Perrin 2007 Health Care Cost Survey.<sup>55</sup> But these costs are for existing employees; unlike public entities, an increasing number of employers are reducing benefits too, asking for increasing contributions from or eliminating all health care benefits for their retirees.

When an approach of increasing the amount that retirees pay for their employer-provided health care has been considered for government employees, so far it has been met with strong resistance and, in several cases, threats of lawsuits. In fact, the lawsuits have already begun where municipalities have begun to reverse prior commitments and charge retirees for health care, one alternative for public entities attempting to reduce their liability exposure. On September 15, 2006, twenty retirees, including a former superintendent, sued Fresno Unified School District, seeking class action status for 3500 retirees and asking that the court order Fresno Unified to stop charging retirees for health benefits, refund all the charges made for the coverage, and restore the district-paid plan to its original form.<sup>56</sup> The litigation by the Retired Employees Association of Orange County concerning the County increasing retirees' health costs by no longer pooling such costs with current employees' health costs is discussed below, as well as whether California law permits such an increase.<sup>57</sup>

### C. Alternatives

There are certainly numerous alternatives to a unilateral downgrade in the municipal bond ratings for troubled states and municipalities. For instance, there are: pension obligation bonds, trusts set up to administer

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53. *Employer Health Benefits: 2007 Summary of Findings*, THE KAISER FAM. FOUND. & HEALTH RESEARCH & EDUC. TR. 3, <http://www.kff.org/insurance/7672/upload/Summary-of-Findings-EHBS-2007.pdf> (last visited Feb. 13, 2012).

54. Byrnes, *supra* note 25.

55. TOWERS PERRIN HR SERVICES, 2007 HEALTH CARE COST SURVEY 1 (2007), *available at* <http://www.towersperrin.com/tp/getwebcachedoc?webc=HRS/USA/2007/200703/07>.

56. Petitioners' Memorandum of Points & Authorities in Support of Second Amended Petition for Writ of Mandate & Other Relief at 1, 10, FURA v. Fresno Unified Sch. Dist., No. 06-CE-CG-03088 (Cal. Super. Ct. Fresno Cnty. Sept. 15, 2006), *available at* <http://www.fura-fusd.org/0202-MPA%20in%20Support%20of%202d%20Am%20Pet%20-%20FINAL.pdf>.

57. *See infra* Part II.D.

the reduction in expense liabilities by funds generated by one or a combination of the other alternatives, a reduction in those services provided by municipalities to reduce costs, elimination of retirement health care benefits for new hires, a reduction in pay increases, and an increase in the number of years of service to qualify for the health care benefits at retirement and tax increases.

Pension obligation bonds could easily be adapted to reduce or eliminate the liabilities. Although the long-term effect of the huge debt increase may be absorbed, the risk is a lowered credit rating or increased funding costs when credit analyses look at the debt ratio involved. Trusts could be set up, jointly managed by a combination of union representatives, employees of the municipalities, management involved, and outside experts. These individuals would be responsible for insuring that the funds raised by a combination of the alternatives are properly used to reduce, and finally eliminate, the liabilities created by the shortfall. Municipalities and states could either increase taxes (such as instituting city or county income taxes) or reduce services provided. Either alternative would be a bitter pill to swallow for the elected officials and in all probability would result in a change at the next election. This alternative would remain a last, but still possible, resort.

Two of the most viable options are either a reduction of future pay raises (such as cost of living or annual increases to help pay for the liability reduction; this would require strong collaboration by appropriate unions who, along with their members, realize what is at stake) or an increase in the time of service before new employees are eligible for the retirement benefit of healthcare. Both of these would substantially reduce both expenses and the increase over time of the growth in the cost of providing health care to retirees. One last alternative is to simply eliminate the benefit for new hires. This would be more difficult as it creates two classes of employees and puts the new hires in a position of reduced salary increases should the union negotiate a reduction to preserve retirement health care benefits.

Even further, there are private firms that use a variety of programs (voluntary employee benefit association or health reimbursement arrangements) as offered by several integrated health care management provider. However, when this additional health care funding is coupled with an aging population, early retirements, and increasing health care costs, the result may well be dramatically increased funding costs for many, if not most, of the states and municipalities.

Another approach would be to follow the federal government's capping of its liability related to prescription drugs in Medicare Part D

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and perhaps allowing the cap to be selective to future employees instead of current employees. Further, capping can be used to limit government's costs per retiree.<sup>58</sup> While this is an alternative that may be explored, unions, it must be recognized, will strongly oppose any type of cap.

According to Medco Health Solutions' Retiree Solutions group Senior Director Ilene Marcus, "states [could] decrease their liability by 20% [to] 40% by transferring risks to an Employer Group Waiver Plan (EGWP) provider . . ."<sup>59</sup> According to Ms. Marcus, GASB 45 can result in an increase of future liability from five to twenty times the current costs so that the reduction of twenty percent to forty percent can be substantial.<sup>60</sup> This type of program allows direct ordering of prescription drugs through an EGWP at substantial discounts to both the state and the retiree or plan participant.<sup>61</sup>

Still another alternative open to state and local governments is to freeze present plans, that is close the plans to new participants creating a second tier of employees. While this is a viable choice, one would anticipate resistance from unions. These newer employees would have a defined contribution plan, such as a 401(k), rather than the traditional and more expensive pension plan. Some states and local municipalities have taken a more stringent approach, closing their plans to new workers and ceasing to accrue additional benefits, effectively converting all employees to a defined contribution plan. While this is still a minority, it is growing more in the New England and Middle Atlantic regions faster than the rest of the country, where twenty-four percent and seventeen percent, respectively, of the plans are now frozen.<sup>62</sup> As can be seen from Exhibit 2 below, there are no significant differences between the category of worker in the state or local government and the plan that is either open or frozen, although somewhat surprisingly, there are more frozen plans for union employees than there are nonunion.<sup>63</sup>

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58. See generally Elizabeth K. Keating & Eric S. Berman, *Unfunded Public Employee Health Care Benefits and GASB 45*, 21 ACCT. HORIZONS 245 (Oct. 2007), available at [http://aaahq.org/GNP/information/activities/2007MYM/Session12\\_KeatingBerman.pdf](http://aaahq.org/GNP/information/activities/2007MYM/Session12_KeatingBerman.pdf).

59. *Will the GASB Rule Changes Hurt Retirees?*, ST. HEALTH WATCH, Nov. 1, 2008.

60. *Id.*

61. Erin Costell, *Medicare Part D and the Plan Sponsor: What you don't know can hurt you and your Bottom Line*, HR MGMT., [http://www.rbshelp.com/articles/PartD\\_ignorance.pdf](http://www.rbshelp.com/articles/PartD_ignorance.pdf) (last visited Feb. 13, 2012).

62. *National Compensation Survey: Employee Benefits in the United States, March 2010*, U.S. BUREAU OF LAB. STAT. (Sept. 2010), <http://www.bls.gov/ncs/ebs/benefits/2010/ebb10046.pdf>.

63. *Employee Benefits Survey*, U.S. BUREAU OF LAB. STAT. (Mar. 2010), <http://www.bls.gov/ebs/benefits/2010/ownership/govt/table28a.htm>.

Exhibit 2  
Open and Frozen Defined Benefit Plans for State and Local  
Government Workers, March 2010

(All workers participating in defined benefit plans = 100 percent)		
Characteristics	Open plans	Frozen plans
All workers	91	9
<i>Worker characteristics</i>		
Management, professional, and related	90	10
Professional and related	90	10
Teachers	91	9
Primary, secondary, and special education school teachers	92	8
Service	91	9
Protective service	91	9
Sales and office	91	9
Office and administrative support	92	8
Natural resources, construction, and maintenance	94	6
Production, transportation, and material moving	90	10
Full time	91	9
Part time	90	10
Union	86	14
Nonunion	95	5
State government	90	10
Local government	91	9
<i>Geographic areas</i>		
New England	74	26
Middle Atlantic	78	22
East North Central	90	10
South Atlantic	98	2
West South Central	94	6
Pacific	88	12

Because the funds for both pension and health care benefits come from the same sources as those for education, public safety, and other

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critical needs, states are increasingly faced with the unpleasant prospect of cutting benefits, raising taxes, or renegotiating public benefit contracts. Since, according to Douglas J. Elliott of the Brookings Institution, state and local pension funds alone face a deficit of up to \$3 trillion and revenues are anticipated to continue to drop as the slow housing recovery continues and tax revenues stagnate, this problem will likely continue to grow.<sup>64</sup> This outcome is forcing governments to reduce the benefits provided to new employees, creating a dual class system. In other cases, states and municipalities are raising the retirement age, increasing the required employee contributions, or both. In New York, in December 2010, the legislature increased the minimum retirement age from fifty-five to sixty-two for new hires, increased the minimum number of years worked to receive a pension from five to ten years, and capped overtime that can be used in the pension calculation.<sup>65</sup> Rhode Island went even further in applying the changes to the retirement age used to begin receiving a pension to all workers, not just new hires.<sup>66</sup>

*D. Funding Changes*

The current process of funding these benefits is to fund as you go with most public sector employers paying for retiree health benefits in the year the benefits are needed by retired workers. At the time when this process began, health insurance was inexpensive and the thought process was to encourage early retirement and bring in less expensive entry-level employees, reducing current employee salary expenses. This approach has been used since retirement health benefits were first provided. For example, in the St. Paul School District in Minnesota the costs were ten dollars per month when the district first offered free health care to retirees thirty years ago.<sup>67</sup> As a consequence, most commitments to municipal and state employees for retirement health care benefits were made without consideration or a study of the long-term consequences. In 2007, only one-third of all the states made consistent contributions (at least ninety percent of their obligations) to

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64. Douglas J. Elliott, *State and Local Pension Funding Deficits: A Primer*, THE BROOKINGS INSTITUTION (Dec. 3, 2010), [http://www.brookings.edu/~media/Files/rc/reports/2010/1206\\_state\\_local\\_funding\\_elliott/1206\\_state\\_local\\_funding\\_elliott.pdf](http://www.brookings.edu/~media/Files/rc/reports/2010/1206_state_local_funding_elliott/1206_state_local_funding_elliott.pdf).

65. THE PEW CENTER ON THE STATES, *supra* note 11, at 9.

66. *Id.*

67. Amity Shlaes, *Social Security: Seriously, We Need to Talk About This*, ST. PAUL PIONEER PRESS, Oct. 21, 2009, at B8.

the pension funds.<sup>68</sup> “Since that time, pension liabilities have grown by \$323 billion, outpacing asset growth by more than \$87 billion.”<sup>69</sup> The majority of the states set aside very little money to pay the increasing costs of retiree health care benefits, preferring a pay-as-you-go basis without regard to the rapidly increasing costs.

*E. The Impact and the Opportunity*

It appears as though neither the vast majority of the public nor municipal bond buyers have considered this rule and few seem to have thought through its possible consequences. Once the figures become clear and the public has had an opportunity to digest their impact on the spending of the states and municipalities, there will likely be an initial negative reaction in the bond market. The financial impact of 2008 and 2009 and resulting budget crisis in state and municipal governments has served to mask the implications of GASB 45. It is simply addressed in the generic “budget short fall,” but in fact has been neglected since 2006.

What is not known, and cannot be known until the solutions are put forth, is either the duration or depth of the consequences. GASB 45 will change the playing field so that this funding for health care benefits for retirees will be similar to pensions in that it is treated as a post-employment benefit and accrued accordingly.<sup>70</sup> This shift from recognition to disclosure is new and the vast majority of actuarial studies have yet to be completed. However, as can be seen from the above figures, the effect of an additional \$1.4 trillion in previously undisclosed debt may well be dramatic. By 2020, California will be spending eight times as much for health care for retirees as they do today, \$31 billion versus \$4 billion today.<sup>71</sup> This kind of increase may well force cuts in services, tax increases, and credit reductions for the various municipalities involved.<sup>72</sup>

Ultimately, GASB 45’s disclosure requirements will affect

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68. THE PEW CENTER ON THE STATES, *supra* note 11, at 1 (citing THE PEW CENTER ON THE STATES, PROMISES WITH A PRICE: PUBLIC SECTOR RETIREMENT BENEFITS 6 (Dec. 2007), available at <http://www.pewcenteronthestates.org/uploadedfiles/Promises%20with%20a%20Price.pdf>).

69. *Id.*

70. Matthew Garrahan, *California Health Costs ‘Set to Rise Sharply,’* FT.COM (Sept. 26, 2006), <http://www.ft.com/intl/cms/s/0/1b02f750-4d70-11db-8704-0000779e2340.html#axzz1boeidRvw>.

71. *Id.*

72. Barbara Feder Ostrov, *Budget Buster Looms for Cities: Today’s Generous Health Packages are Tomorrow’s Fiscal Sinkhole*, SAN JOSE MERCURY NEWS, Sept. 28, 2006, at 1B.



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virtually all public sector employers, including states, cities, and school districts.<sup>73</sup> Every one of these public entities has issued municipal bonds and will need to continue to do so in the future. At some point the bond rating agencies must take into account the unfunded liability that results from the retiree health care costs. There is little doubt that unless these public entities are able to address the increase in debt in some manner that is acceptable to Moody's and Standard & Poor's credit analysts, these increases must begin to affect the bond ratings. Any downward revision in bond ratings will increase the cost of the affected municipality or state's cost to borrow. As the bond's credit rating drops, the cost of borrowing rises for present and future borrowing in order to equalize the yield. This will be a significant motivator to elected officials as they come under increasing pressure as bond values drop and the cost of borrowing correspondingly increases while services continue to be cut and taxes increased.

Unlike private sector benefits, public sector benefits are often protected by union contracts and state laws and, where this protection is in doubt, costly class action lawsuits, as outlined above, will likely result, further straining the public entity budgets. With the increasing costs of health care and pensions, the increasing number of public sector employees reaching sixty-five, and the difficulty of changing the various and complex health care commitments made to retirees by public entities, the financial outlook for states and municipalities appears gray. In the short run, the credit ratings of municipal bonds, whose issuing municipalities are unable to offer a viable plan to meet the revised obligations, may suffer. This will force a decline in pricing so that the increased risk is reflected in the higher yield. While the ultimate solution may take several years to work out, those years may be a time to be careful for investors about what municipal bonds are held as the short term price declines could be substantial. This drop, which one of the authors believes will be temporary, may drag down the pricing of those municipal bonds even where a viable plan has been put forth. This effect was illustrated in the study by John M. Halstead, Shantaram Hegde, and Linda Schmid Klein, in which there was a negative impact on securities simply exposed to Orange County's problems in 1995.<sup>74</sup> According to that article, there were significant abnormal returns resulting from the Orange County bankruptcy.<sup>75</sup> This

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73. THE ANTICIPATED IMPACT OF GOV'T ACCOUNTING STANDARDS BD. (GASB) STANDARD 45, <http://iafc.cms-plus.com/files/GASB45Qa3.pdf> (last visited Feb. 13, 2012).

74. John M. Halstead et al., *Orange County Bankruptcy: Financial Contagion in the Municipal Bond and Bank Equity Markets*, 39 FIN. REV. 293, 313 (2004).

75. *Id.* at 302-06.

study observed that there was a negative impact on securities exposed to Orange County, municipal bond funds not containing Orange County bonds, and non-Orange County bonds as well.<sup>76</sup> When this fact is coupled with the simple fact, as can be seen in Exhibit 3 below,<sup>77</sup> that a greater percentage of the earned income is replaced for public versus private sector at age sixty-five, regardless of years of service.

## Exhibit 3

Average replacement rate for specified final earnings and years of service for retirement at age sixty-five

Private EE's Pension Only				Public EE's Pension Only			
	10	20	30		10	20	30
\$15,000	12.2%	24.5%	36.8%	\$15,000	17.3%	34.1%	51.0%
\$35,000	10.1%	20.1%	29.2%	\$35,000	17.2%	34.1%	51.0%
\$65,000	9.6%	19.2%	28.9%	\$65,000	17.3%	34.2%	51.0%

  

Private EE's Pension & Social Security				Public EE's Pension & Social Security			
	10	20	30		10	20	30
\$15,000	39.3%	62.8%	84.2%	\$15,000	44.8%	73.7%	100.0%
\$35,000	28.1%	47.3%	64.6%	\$35,000	35.8%	62.1%	86.8%
\$65,000	22.2%	37.7%	49.7%	\$65,000	30.4%	53.7%	73.0%

Although, per the Bureau of Labor Statistics (BLS), the total employer costs for all employee related compensation in 2009 differ between the state and local public sector (\$39.66 per hour worked) and the private sector (\$27.42 per hour worked) or 1.45 to one public to private, the proportions allocated to employee benefits are even higher for public over the private employers, \$13.65 versus \$8.02, for a ratio of 1.7 of public over private costs.<sup>78</sup> Pension costs made up 10.94% of the total benefits package for public sector employees and 1.49% of the total benefits package in the private sector.<sup>79</sup> Costly class action

76. *Id.* at 313.

77. Ann C. Foster, *Public and Private Sector Defined Benefit Pensions: A Comparison*, COMPENSATION & WORKING CONDITIONS, Summer 1997, at 41, available at <http://www.bls.gov/opub/cwc/archive/summer1997art5.pdf>.

78. Chris Edwards, *Employee Compensation in State and Local Governments*, TAX & BUDGET BULL. (Cato Inst.), Jan. 2010, at 1, available at <http://www.cato.org/pubs/tbb/tbb-59.pdf>.

79. *Id.*

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lawsuits to protect public sector employee benefits under union contracts or state statutes, as outlined above, may result, further straining the public entity budgets. With the increasing costs of health care, the increasing number of public sector employees reaching sixty-five, and the difficulty of changing the various and complex health care commitments made to retirees by public entities, the outlook for a stable municipal bond market is foggy. As can be seen in Exhibit 3, the amount of income replacement for public employees is much higher than that of private sector employees. If we look at the statistics both with and without social security, we see that in every case public employees receive a significantly higher portion of replacement income during retirement. This will continue to be a focus for the press and the courts as lawsuits are brought by elected officials to reduce benefits to something comparable to the private sector. While this may not be possible for existing employees, a vigorous exploration of the prospect for new employees in the public sector can be expected. The typical response is that public employees have accepted lower salaries thus somewhat justifying the higher percentage replacement and “back end reward.”

## II. LIMITATIONS ON RESTRICTING BENEFITS: ARE HEALTH BENEFITS FOR STATE AND LOCAL EMPLOYEES IN CALIFORNIA A VESTED BENEFIT AND HOW MAY THEY BE REDUCED?

State and local governments looking to reduce the costs of benefits to their employees might have an easier time of reducing health benefits than retirement benefits.<sup>80</sup> The State of California is a case-in-point on the difference in restrictions on reducing pension benefits versus health benefits. Although California law does appear to extend the protection of the contracts clauses of the federal and state constitutions to contractual employment benefits other than pensions,<sup>81</sup> the question for

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80. See John Sanchez, *The Vesting, Modification, and Financing of Public Retiree Health Benefits in Light of New Accounting Rules*, 41 J. MARSHALL L. REV. 1147, 1150-51 (2008).

81. Cal. League of City Emp. Ass'ns v. Palos Verdes Library Dist., 150 Cal. Rptr. 739, 740 (Ct. App. 1978) (longevity salary increase, fifth week of vacation after ten years of continuous service, and four-month paid sabbatical at the end of each six years of full-time service); see also Youngman v. Nev. Irrigation Dist., 449 P.2d 462, 467-68 (Cal. 1969) (practice of granting annual wage increases); Frates v. Burnett, 87 Cal. Rptr. 731, 734 (Ct. App. 1970) (rules and regulations adopted by Board of Education are a part of teacher's employment contract); Ivens v. Simon, 27 Cal. Rptr. 801, 802, 805 (Dist. Ct. App. 1963) (adoption of five-step classification and pay plan); Healdsburg Police Officers Ass'n v. Healdsburg, 129 Cal. Rptr. 216, 219 (Ct. App. 1976) (departmental manual providing for hearing).

the courts has often been whether such other contractual employment benefits have arisen.<sup>82</sup>

In difficult economic times where there has been apparent political sentiment to reduce state and local government employees' benefits, federal courts applying California law have sought to decide whether or not health benefits provided by an employer were a contractual obligation protected by the federal and state constitutions' contracts clauses. In *San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System*, the Ninth Circuit distinguished between the California cases *California League of City Employees Ass'n v. Palos Verdes Library District* and *San Bernardo Public Employees Ass'n v. Fontana*, and held, among other matters, that eligibility requirements for retiree health benefits were longevity-based and could be renegotiated as part of a collective bargaining agreement.<sup>83</sup> On the other hand, in *Retired Employees Ass'n of Orange County, Inc. v. Orange*, the same Ninth Circuit certified a question to the California Supreme Court concerning "whether, as a matter of California law, a California county and its employees can form an implied contract that confers vested rights to health benefits on retired county employees."<sup>84</sup>

Both the California Constitution ("[a] law impairing the obligation of contracts may not be passed")<sup>85</sup> and the U.S. Constitution ("No state shall . . . pass any . . . [l]aw impairing the [o]bligation[s] of [c]ontracts . . .")<sup>86</sup> prohibit impairments of contracts and these clauses "limit the power of public entities to modify their . . . contracts with other parties."<sup>87</sup> In order to determine whether, particularly, health benefits of retirees may be modified in California, it may be instructive to review the cases *California League*, *San Bernardino Pub Employees Ass'n*, *San Diego Police Officers' Ass'n*, *Retired Employees Ass'n of*

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82. *San Bernardino Pub. Emps. Ass'n v. Fontana*, 79 Cal. Rptr. 2d 634, 639, 641 (Ct. App. 1998) (longevity pay, leave accrual increases based on longevity, and paid retiree medical and dental benefits); *see also* *Butterworth v. Boyd*, 82 P.2d 434, 439-40 (Cal. 1938) (compulsory salary deductions for cost of medical insurance may be added to contract); *see also generally* *Vielehr v. California*, 163 Cal. Rptr. 795 (Ct. App. 1980) (statute reducing amount of interest paid to employees who withdrew pension fund contributions upon leaving public service before retirement).

83. 568 F.3d 725, 739-40 (9th Cir. 2009) (citing *Cal. League of City Emps. Ass'n v. Palos Verdes Library Dist.*, 150 Cal. Rptr. 739 (Ct. App. 1978); *San Bernardino Pub. Emps. Ass'n*, 79 Cal. Rptr. 2d 634).

84. 610 F.3d 1099, 1101 (9th Cir. 2010); *see also infra* notes 136-47 and accompanying text.

85. CAL. CONST. art. I, § 9.

86. U.S. CONST. art I, § 10, cl. 1.

87. *San Bernardino Pub. Emps. Ass'n*, 79 Cal. Rptr. 2d at 638 (citing *Bd. of Admin. of the Pub. Emps.' Ret. Sys. v. Wilson*, 61 Cal. Rptr. 2d 207, 222 (Ct. App. 1997)).

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*Orange County*, and cases cited therein.

California may well be a bell weather as to whether other states may be able to modify mounting, and often unfunded, health benefits for retirees as the baby boom generation moves into the status of retired state and local government employees.

A. *California League of City Employee Ass'ns v. Palos Verdes Library District*

In *California League of City Employee Ass'ns v. Palos Verdes Library District*, the benefits at issue were not health benefits for current or retired employees, but rather “longevity” benefits.<sup>88</sup> Although courts in other states may refer to pensions and other employee benefits as “vested” when protected by the contract clause of a federal or state constitution,<sup>89</sup> the California courts, such as in *California League*, generally refer to “obligations” as “protected” or not under the contract clause.<sup>90</sup> The *California League* court, as well as other courts, has recognized that protected obligations are not limited to pensions “that an employee begins earning . . . from the day he starts employment . . . ‘and the employing governmental body may not deny or impair the contingent liability . . . .’”<sup>91</sup> The benefits at issue in *California League* were “a longevity salary increase . . . [,] a [fifth] week of vacation . . . after [ten] years of continuous service[,] and . . . a [four]-month . . . paid sabbatical . . . at the end of each [six] years of full-time service.”<sup>92</sup>

The *California League* court determined that the benefits in question were “protected” by analyzing that they were “fundamental.”<sup>93</sup> The *California League* court cited *Bixby v. Pierno* and quoted the court as stating that the standard to evaluate whether the benefits were fundamental was “the effect of it in human terms and the importance of it to the individual in the life situation.”<sup>94</sup> The *California League* court held that the benefits were protected and fundamental because “the benefits were important to the employees, had been an inducement to remain employed with the district, and were a form of compensation

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88. 150 Cal. Rptr. 739, 740 (Ct. App. 1978).

89. See Sanchez, *supra* note 80, at 1168-69.

90. *Cal. League of City Emp. Ass'ns*, 150 Cal. Rptr. at 741 (quoting *Kern v. Long Beach*, 179 P.2d 799, 802 (Cal. 1947)).

91. *Id.* (quoting *Kern*, 179 P.2d at 803).

92. *Id.* at 740.

93. *Id.* at 741.

94. *Id.* at 741-42 (quoting *Bixby v. Pierno*, 481 P.2d 242, 252 (Cal. 1971)).

which had been earned by remaining in employment.”<sup>95</sup>

The courts in *San Bernardino Public Employees Ass’n v. Fontana*, the Fourth Appellate District Court of Appeal in California, and *San Diego Police Officers’ Ass’n v. San Diego City Employees’ Retirement System*, the Ninth Circuit Federal Court of Appeals, discussed below, both criticized *California League* as misreading *Bixby*<sup>96</sup> and stating the test was not whether the benefits were fundamental, but rather whether “statutory language and circumstances accompanying its passage clearly . . . evince a legislative intent to create private rights of a contractual nature enforceable against the State.”<sup>97</sup> The *California League* court, after finding that the benefits in question were protected obligations, then sought to determine whether the modifications in those benefits were reasonable under a standard that the “modifications must ‘bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages.’”<sup>98</sup> The *California League* court held that a general salary increase did not meet the reasonable modification standard in the case before it.<sup>99</sup>

#### B. *San Bernardino Public Employees Ass’n v. Fontana*

In *San Bernardino Public Employees Ass’n*, the benefits under consideration were “longevity pay, leave accrual increases based on longevity, and paid retiree medical and dental insurance benefits.”<sup>100</sup> The appellate court overturned the trial court’s ruling, which the lower court based on *California League*, and rejected *California League*’s reading of *Bixby*, “[t]he case cannot fairly be read as establishing a new measure of substantive rights to be protected under the contract clause.”<sup>101</sup> As discussed previously, *California League* had read *Bixby* to say that, if a court found benefits to be fundamental, then a court could protect the benefits under the contracts clause.<sup>102</sup>

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95. *Cal. League of City Emp. Ass’ns*, 150 Cal. Rptr. at 742.

96. *San Bernardino Pub. Emps. Ass’n v. Fontana*, 79 Cal. Rptr. 2d 634, 638 (Ct. App. 1998); *San Diego Police Officers’ Ass’n v. San Diego City Emps.’ Ret. Sys.*, 568 F.3d 725, 740 (9th Cir. 2009).

97. *San Bernardino Pub. Emps. Ass’n*, 79 Cal. Rptr. 2d at 638 (quoting *Valdes v. Cory*, 189 Cal. Rptr. 212, 222 (Ct. App. 1983)).

98. *Cal. League of City Emp. Ass’ns*, 150 Cal. Rptr. at 742 (quoting *Allen v. Long Beach*, 287 P.2d 765, 767 (Cal. 1955)).

99. *Id.*

100. 79 Cal. Rptr. 2d at 636.

101. *Id.* at 635, 638.

102. *Id.* at 638 (citing *Cal. League of Emp. Ass’ns*, 150 Cal. Rptr. at 741-42).

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The *San Bernardino Public Employees Ass'n* court relied on *Valdes v. Cory* requiring statutory language and evincing “a legislative intent to create private rights of a contractual nature enforceable against the State.”<sup>103</sup> The court also relied on *Butterworth v. Boyd* stating “the employees had no legitimate expectation that . . . longevity-based benefits would continue unless they were renegotiated as part of a new bargaining agreement.”<sup>104</sup> However, in *San Bernardino Public Employees Ass'n*, apparently the issue of whether retiree health benefits were protected obligations, which could only be modified reasonably, was not ripe for review, in contrast to longevity pay and leave accruals.<sup>105</sup> Thus, as the appellate court said, the trial court’s opinion was merely “an advisory opinion.”<sup>106</sup> In this case, the city employer was still negotiating with the employees’ representative: “both the City and the PBA agree[d] to meet and confer regarding the additional incremental costs of future benefits.”<sup>107</sup> Thus, reliance on *San Bernardino Public Employees Ass'n* regarding the unprotected nature of health benefits and modifications may be reliance on mere dicta.

It seems then, that there is clearly a conflict between the California Court of Appeal. The Second Appellate District in *California League* held that benefits which are fundamental to employees are protected, but the Fourth Appellate District in *San Bernardino Public Employees Ass'n* rejected that analysis in favor of an analysis of whether “a legislative intent to create private rights of a contractual nature enforceable against the State” had been evinced.<sup>108</sup> Now the Ninth Circuit Federal Court of Appeals has entered this area of interpretation of California law regarding employee health benefits in two cases: *San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System*<sup>109</sup> and *Retired Employees Ass'n of Orange County, Inc. v. Orange*.<sup>110</sup>

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103. 79 Cal. Rptr. 2d at 638 (quoting *Valdes v. Cory*, 189 Cal. Rptr. 212, 222 (Ct. App. 1983)).

104. *Id.* at 639.

105. *Id.* at 640, 641.

106. *Id.* at 641.

107. *Id.* at 640.

108. Compare 79 Cal. Rptr. 2d at 638, with *Cal. League of City Emp. Ass'ns v. Palos Verdes Library Dist.*, 150 Cal. Rptr. 739, 741-42 (Ct. App. 1978).

109. 568 F.3d 725 (9th Cir. 2009).

110. 610 F.3d 1099 (9th Cir. 2010).

C. San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System

In *San Diego Police Officers' Ass'n*, the plaintiff, Police Officers' Association, had filed the lawsuit in federal district court.<sup>111</sup> Among its claims was that the modification in eligibility for retirement health benefits violated the contracts clauses of the federal and California Constitutions.<sup>112</sup> In adjudicating the claims under the contracts clauses, the Federal Court of Appeals explained the relationship between the state and federal law as follows:

Although federal courts look to state law to determine the existence of a contract, federal rather than state law controls as to whether state or local statutes or ordinances create contractual rights protected by the Contracts Clause. Nevertheless, federal courts do “accord respectful consideration and great weight to the views of the [s]tate’s highest court.” Under federal law the state’s statutory language must evince a clear and unmistakable indication that the legislature intends to bind itself contractually before a state legislative enactment may be deemed a contract for purposes of the Contracts Clause.<sup>113</sup>

Under an imposed final offer, the city in *San Diego Police Officers' Ass'n* had imposed modifications in eligibility requirements for retiree health benefits for current employees hired before July 1, 2005.<sup>114</sup> Those requirements “established service qualifications of [ten] years for a 100% benefit and [five] years for a 50% benefit.”<sup>115</sup> The Ninth Circuit rejected the *California League* reasoning that longevity benefits might be fundamental and therefore protected obligations in favor of the *San Bernardino Public Employees Ass'n* reasoning that longevity benefits were not intended to be protected:

But we find the reasoning in *Cal. League* unpersuasive because the court there did not acknowledge the heavy burden on a plaintiff to “overcome [the] well-founded presumption” that a legislative body does not intend to bind itself contractually, nor did it look to the legislative body’s intent to create vested rights. Instead we find the analysis in *San Bernardino Pub. Employees Ass'n v. City of Fontana* far better attuned to the principles that we have articulated . . . . That inquiry into the legislative intent to create a contract is consistent with our analysis as to the existence of a contract. Were the recognition of constitutional contract rights to be based on the importance of benefits

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111. 568 F.3d at 732.

112. *Id.* at 736.

113. *Id.* at 737 (citations omitted).

114. *Id.* at 739.

115. *Id.*



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to individuals rather than on the legislative intent to create such rights, the scope of rights protected by the Contracts Clause would be expanded well beyond the sphere dictated by traditional constitutional jurisprudence.<sup>116</sup>

The *San Diego Police Officers' Ass'n* court held that the retiree medical benefits in the case were similar to the benefits in *San Bernardino Public Employees Ass'n* and “were considered a term of employment that could be negotiated through the collective bargaining process.”<sup>117</sup> Therefore, the court concluded, “[a]s such, they were longevity-based benefits that *continued only insofar as they were renegotiated as part of a new agreement* and were not protectible contract rights.”<sup>118</sup>

Clearly, the Ninth Circuit Federal Court of Appeals could not have been clearer in its preference for the *San Bernardino Public Employees Ass'n* case over *California League*. However, the Ninth Circuit may have had a change of heart in its decision to continue interpreting California state law when an issue of retiree medical benefits was again brought to it in the case *Retired Employees Ass'n of Orange County, Inc. v. Orange*. That case is discussed in the next section of this article.

*D. Retired Employees Ass'n of Orange County, Inc. v. Orange*

In *Retired Employees Ass'n of Orange County, Inc. v. Orange*, the federal district court held that as a matter of law, the defendant county could not be liable under the state and federal Constitutions' contracts clauses “in the absence of explicit legislative or statutory authority.”<sup>119</sup> The Employees Association argued that the County's revocation of a pooling agreement, by which retirees' health insurance costs were pooled with current health insurance costs, violated “the prohibition [of] impairment of . . . obligation[s] of contracts” contained in the U.S. and California Constitutions.<sup>120</sup> The pooling of the retirees' costs with those of current employees lowered the premium for retirees.<sup>121</sup> The district court rejected the argument of the plaintiff that “an implied term of the memorand[um] of understanding between the parties” was the pooling benefit and that this benefit was “an element of deferred compensation”

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116. *San Diego Police Officers' Ass'n*, 568 F.3d at 740 (citations omitted).

117. *Id.*

118. *Id.* (emphasis added).

119. 632 F. Supp. 2d 983, 987 (C.D. Cal. 2009).

120. *Retired Emps. Ass'n of Orange Cnty., Inc. v. Orange*, 610 F.3d 1099, 1102 (9th Cir. 2010), *certified questions to*, 632 F. Supp. 2d 983 (C.D. Cal. 2009).

121. *Retired Emps. Ass'n of Orange Cnty.*, 632 F. Supp. 2d at 984.

entitled to protection for the retirees.<sup>122</sup> The court cited California cases requiring “explicit language in statutes or legislative enactments” in order for a contractual obligation to arise.<sup>123</sup> Also, the district court cited other cases rejecting plaintiff employees’ claims where there was no statutory provision or legislative enactment.<sup>124</sup>

The Ninth Circuit Court of Appeals in *Retired Employees Ass’n of Orange County* decided to certify the following question to the Supreme Court of California: “[w]hether, as a matter of California law, a California county and its employees can form an implied contract that confers vested rights to health benefits on retired county employees.”<sup>125</sup> The Ninth Circuit explained its decision to certify the question to the California Supreme Court as follows:

For [the] purposes of [the] Contract Clause analysis, “federal courts look to state law to determine the existence of a contract.” In light of the conflicting contentions of the parties, and in light of the great practical importance of the question, we do not think that it is appropriate to substitute our judgment on this issue of state law for the judgment of the California Supreme Court.<sup>126</sup>

As suggested previously, having once faced the question of whether particular retired employee health benefits were protected obligations under the contract clause of California law in *San Diego Police Officers’ Ass’n*, the Ninth Circuit may have decided that California’s highest court could more appropriately resolve the possible conflict among the California appellate courts. Given the analysis of *California*

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122. *Id.* at 986, 987.

123. *Id.* at 986; *see, e.g.*, *Thorning v. Hollister Sch. Dist.*, 15 Cal. Rptr. 2d 91, 97 (Ct. App. 1992) (vested right to post-retirement continuation of paid health care benefits per school district’s official declaration of policy); *Cal. Teachers Ass’n v. Cory*, 202 Cal. Rptr. 611, 618 (Ct. App. 1984) (Education Code “manifest[ed] a continuing obligation to fund the Teachers’ Retirement Fund in future years pursuant to statutory formulae.”); *Valdes v. Cory*, 189 Cal. Rptr. 212, 223 (Ct. App. 1983) (explicit language in retirement law regarding set monthly contributions to PERS); *Teachers’ Ret. Bd. v. Genest*, 65 Cal. Rptr. 3d 326, 338 (Ct. App. 2007) (legislative intent of California Education Code to establish supplemental payments as vested); *Kern v. Long Beach*, 179 P.2d 799, 802 (Cal. 1947) (city charter provided vested right).

124. *Retired Emps. Ass’n of Orange Cnty., Inc.*, 632 F. Supp. 2d at 987; *see, e.g.*, *Ventura Cnty. Retired Emps.’ Ass’n, Inc. v. Ventura*, 279 Cal. Rptr. 676, 679 (Ct. App. 1991) (single and uniform premium for retiree and active employee insureds not mandated by statute); *Sappington v. Orange Unified Sch. Dist.*, 14 Cal. Rptr. 3d 764, 766, 767, 768 (Ct. App. 2004) (Unified School District Board of Education’s policy to underwrite the cost of medical and hospital insurance for retirees with ten years of service reflected a “magnanimous spirit, not a contractual mandate.”).

125. *Retired Emps. Ass’n of Orange Cnty.*, 610 F.3d at 1101.

126. *Id.* at 1102 (quoting *San Diego Police Officers’ Ass’n v. San Diego City Emps.’ Ret. Sys.*, 568 F.3d 725, 737 (9th Cir. 2009)).

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*League* based on the fundamental importance of a benefit to employees versus the analysis of *San Bernardino Public Employees' Ass'n* based on the intention of the legislature to create a private contractual right enforceable against the state, there appears to be a conflict between the California state courts of appeal.

The California Supreme Court answered the certified question from the Ninth Circuit by responding to three arguments. The County had argued (1) no implied contracts between government employer and employees, (2) no vested benefits in implied contracts if such contracts are allowed, and (3) no vested implied health insurance benefit.<sup>127</sup> First, the California Supreme Court stated “[o]ur precedents similarly find, in the public employment context, that ‘[g]overnmental subdivisions may be bound by an implied contract if there is no statutory prohibition against such arrangements.’”<sup>128</sup> The court expressly stated that the decision of “[w]hether . . . the continuation of a single unified pool for purposes of setting health insurance premiums for retired Orange County employees can be implied from Board resolutions, including those resolutions approving the [collectively bargained] memoranda of understanding, is beyond the scope of the certified question . . . .”<sup>129</sup> Furthermore, the Court stated that a “‘clear showing’ that legislation was intended to create the asserted contractual obligation” was required because of the presumption that a statutory scheme is not intended to create private contractual or vested rights.<sup>130</sup>

Secondly, the California Supreme Court stated that “[v]esting remains a matter of the parties’ intent.”<sup>131</sup> The court agreed with the criticism of *California League* that the *California League* court should have focused on “the legislative body’s intent to create vested rights” and “the plaintiff’s ‘heavy burden’ to demonstrate that intent.”<sup>132</sup> But the Supreme Court agreed, “none of this criticism [supports the] quarrel with the underlying theory . . . that public employee benefits, in appropriate circumstances, could become vested . . . .”<sup>133</sup> The Supreme Court also cited *Navlet v. Port of Seattle*, a Washington case cited by

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127. *Retired Emps. Ass'n of Orange Cnty., Inc. v. Orange*, 52 Cal. 4th 1171, 1179 (Cal. 2011).

128. *Id.* (quoting *Youngman v. Nev. Irrigation Dist.*, 449 P.2d 462, 466 (Cal. 1969)).

129. *Id.* at 1188.

130. *Id.* at 1188-89 (quoting *Parker v. Wakelin*, 123 F.3d 1, 5 (1st Cir. 1997)).

131. *Id.* at 1189.

132. *Retired Emps. Ass'n of Orange Cnty., Inc.*, 52 Cal. 4th at 1190 (quoting *San Diego Police Officers' Ass'n v. San Diego City Emps.' Ret. Sys.*, 568 F.3d 725, 740 (9th Cir. 2009)).

133. *Id.*

REAO in which the Washington court found an implied “vested right to lifetime health and welfare benefits for employees who [had] reached retirement age during the term of [a] collective bargaining agreement.”<sup>134</sup> Again, the Supreme Court indicated whether a vested right was implied in the litigation before it was beyond the scope of the certified question and that “a clear basis in the contract or convincing extrinsic evidence” was required.<sup>135</sup>

Thirdly, the California Supreme Court stated that “under California law, a vested right to health benefits for retired county employees can be implied . . . .”<sup>136</sup> The Court found that the antivesting language of a particular California statute did not apply to REAO’s attempt “to preserve a particular methodology by which the health benefit premiums of active and retired employees are calculated.”<sup>137</sup>

Upon receiving the answer from the California Supreme Court to the certified question, the Ninth Circuit remanded its case to the federal district court.<sup>138</sup>

### III. WHAT PUBLIC POLICIES UNDERLIE HEALTH AND OTHER RETIREMENT BENEFITS FOR STATE AND LOCAL EMPLOYEES?

Courts have acknowledged that public employees often accept less compensation in exchange for the financial security of a steady paycheck and benefits such as pensions and health coverage.<sup>139</sup> Courts have also acknowledged that “to ensure the continued recruitment and retention of qualified and competent state employees[,]” a legislature might even grant “retroactive salary adjustments for periods during which they worked with justifiable uncertainty regarding their salary levels.”<sup>140</sup> The analysis in cases such as *California League* appears to be that it is more reasonable to hold that employees, other than new employees, are looking to the continuation of a benefit which has been offered and upon which they have relied. Despite what some cases have indicated,<sup>141</sup> possibly where there has been a course of conduct by the

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134. *Id.* at 1191 (citing *Navlet v. Port of Seattle*, 194 P.3d 221, 224 (Wash. 2008)).

135. *Id.*

136. *Id.* at 1194.

137. *Retired Emps. Ass’n of Orange Cnty., Inc.*, 52 Cal. 4th at 1193 (finding that the antivesting provision of California Government Code section 31692 did not apply).

138. *Retired Emps. Ass’n of Orange Cnty., Inc. v. Orange*, 663 F.3d 1292, 1292 (9th Cir. 2011).

139. *See Roth v. Glendale*, 614 N.W.2d 467, 472 (Wis. 2000).

140. *Orange v. Ass’n of Orange Cnty. Deputy Sheriffs*, 121 Cal. Rptr. 3d 151, 163-64 (Ct. App. 2011) (quoting *Jarvis v. Cory*, 620 P.2d 598, 607 n.10, 608 (Cal. 1980)).

141. *See Sanchez, supra* note 80, at 1175.

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governmental employer and reasonable reliance thereon by the employee, there should be some basis for the application of the principle of promissory estoppel forming a contract protected under the Contracts Clause. On the other hand, the California Supreme Court in *Retired Employees Ass'n of Orange County* held that a contract term conferring a vested benefit could be implied from extrinsic evidence, including governmental board approval of collective bargaining agreements.<sup>142</sup> In the authors' view, the decision may come down to what benefits the society wants to afford its members who take on government employment, which often involves an amount of self-sacrificing service to the public in positions such as those at educational institutions, firefighting, police organizations, and, at the federal level, for example, the post office. Perhaps also the public could look upon benefits afforded these public servants as not excessive, particularly when colored by transitory economic downturns, but rather ask why such benefits are not afforded other employees in the society.

In this light then perhaps *California League's* analysis relying on the fundamental nature or importance of benefits to government employees, rather than a strict explicit contract analysis, may make more sense for a society and its future. *California League* may be more in tune with the intent of the parties than even *Retired Employees Ass'n of Orange County* at the California Supreme Court level. Such an analysis as *California League's* would appear to be more in accord with the general sentiment of the courts to afford public employees some degree of security rather than an explicit contract analysis, which leaves the court recommending to the employees that they petition the sovereign.<sup>143</sup> Perhaps the Reverend Jessie Jackson's recent analysis that there needs to be a balance between employer, government, and employees still applies in the situation where the employer and the government are one and the same.<sup>144</sup> And, thus, the analysis that government employee unions contribute to the campaigns of their employers is not quite on point in that private business employers also contribute to the campaigns of government regulators.<sup>145</sup> In fact,

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142. *Retired Emps. Ass'n of Orange Cnty., Inc.*, 52 Cal. 4th at 1188.

143. *Retired Emps. Ass'n of Orange Cnty., Inc. v. Orange*, 632 F. Supp. 2d 983, 988 (C.D. Cal. 2009).

144. Scott Bauer, *Wisconsin Democrats Could Stay Away for Weeks*, SIGNONSANDIEGO.COM, Feb. 18, 2011, <http://www.signonsandiego.com/news/2011/feb18/wisconsin-democrats-could-stay-away-for-weeks>.

145. See David G. Crane, *Should Public Employees Have Collective Bargaining?*, S.F. CHRON., Feb. 27, 2011, at F7.

government employees may be a bit more in need of protection of the courts and collective bargaining in that there is not the three-party balanced wheel that Reverend Jackson envisioned when the employer and the government are one and the same.

Despite all the evidence that retiree health benefits in particular are unfunded or underfunded, in contrast to pension benefits which have generally been prefunded and will expect to be more fully funded when economic times and the investments of those pension funds take an upturn, surely, if there was any miscalculation, it was in promising retiree health benefits without prefunding them. The question now, both at the employee/employer level and at the society level, is whether health benefits for the retirees, which apparently have been relied upon, can be altered or modified, other than within the traditional reasonableness standard which the *California League* analysis extended to benefits beyond merely pension benefits.

Perhaps this is the type of reasoning the *California League* court was reaching for when it held that certain benefits were fundamental obligations protected by the contract clauses.<sup>146</sup> The *California League* court quoted *Bixby v. Pierno* stating, “[w]hile the three benefits in question may not be as important to an employee as a pension, in determining whether they are fundamental the court is to evaluate ‘the effect of it in human terms and the importance of it to the individual in the life situation.’”<sup>147</sup> Both the *San Bernardino Public Employees Ass’n* case and the *San Diego Police Officers’ Ass’n* case criticize *California League* for its reliance on *Bixby*.<sup>148</sup> The *San Bernardino Public Employees’ Ass’n* court, as cited favorably by the *San Diego Police Officers’ Ass’n* court, stated as follows: “[t]he *California League* court’s reliance on *Bixby* is misplaced. *Bixby* merely established a rule of judicial review applicable to adjudicatory orders or decisions of public agencies. The case cannot fairly be read as establishing a new measure of substantive rights to be protected under the contract clause.”<sup>149</sup>

However, *California League’s* reliance on *Bixby* may be quite appropriate. *Bixby* was establishing a standard for reviewing an

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146. *Cal. League of City Emp. Ass’ns v. Palos Verdes Library Dist.*, 150 Cal. Rptr. 739, 741-42 (Ct. App. 1978).

147. *Id.* (quoting *Bixby v. Pierno*, 481 P.2d 242, 252 (Cal. 1971)).

148. *San Bernardino Pub. Emps. Ass’n v. Fontana*, 79 Cal. Rptr. 2d 634, 638 (Ct. App. 1998); *San Diego Police Officers’ Ass’n v. San Diego City Emps.’ Ret. Sys.*, 568 F.3d 725, 740 (9th Cir. 2009).

149. *San Diego Police Officers’ Ass’n*, 568 F.3d at 740 (quoting *San Bernardino Public Emps. Ass’n*, 79 Cal. Rptr. 2d at 638).

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administrative decision by the Commissioner of Corporations.<sup>150</sup> The plaintiff complained that the administrative decision was not supported by substantial evidence and was an abuse of discretion.<sup>151</sup> The *Bixby* court held that if an administrative decision substantially affected a vested fundamental right, the court would not “only examine[] the administrative record[,] but also exercise[] . . . independent judgment . . . in a limited trial de novo.”<sup>152</sup> Furthermore, the *Bixby* court explained that “[i]n determining whether the right is fundamental[,] the courts do not alone weigh the economic aspect of it, but the effect of it in human terms and the importance of it to the *individual* in the life situation.”<sup>153</sup>

It is for that last statement that the *California League* court cited *Bixby*. Would not the imposition of a contract, for example such as in *San Diego Police Officers’ Ass’n*, upon the employees be an administrative decision for which the court would need to look to the appropriate standard as to whether it could review such decision more or less in depth. Once the *California League* court determined it could review the Palos Verdes Library District’s decision under the *Bixby* standard, it also found a violation of the contracts clauses, unless the particular protected benefits were modified reasonably.<sup>154</sup> At least the *California League* analysis would likely cause governmental entities to be more precise in negotiating contractual language, particularly concerning benefits, the benefits’ protected status, and the ability to renegotiate such benefits. In fact, if a court were to interpret the *Bixby* standard to require that the importance of an employee benefit be determined on an individual-by-individual basis, the governmental employer would want to be extremely precise in negotiating contract language.

In order to avoid the possible subjective effect of the language in the *Bixby* standard, courts most likely need to interpret the individual of the standard as the objective or reasonable individual, if the courts can choose to use the *Bixby* standard as used in *California League* after the California Supreme Court’s decision on *Retired Employees Association of Orange County*. Even the California Supreme Court, though, only criticized the *California League* court for not focusing on the legislative intent and employee’s heavy burden and not explicitly for relying on

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150. *Bixby*, 481 P.2d at 244.

151. *See id.*

152. *Id.* at 251.

153. *Id.* at 252 (emphasis added).

154. *Cal. League of City Emp. Ass’ns v. Palos Verdes Library Dist.*, 150 Cal. Rptr. 739, 741-42 (Ct. App. 1978).

*Bixby*. In a case with a large number of employees, a court might have more difficulty in applying the *Bixby* standard. If a court made individual determinations of importance, the court could be confronted with an enormous amount of work in applying the standard on an individual basis rather than on an objective reasonable basis. Further, since state law determines whether a contract exists, and federal law determines whether the federal contracts clause applies, it is possible that a state court could find an implied contract, but that such contract might not be protected by the federal contracts clause in that the legislature's intent might not be clearly evinced for purposes of the federal contracts clause.<sup>155</sup>

Still, the *California League* analysis may be more directly related to the issue of whether an obligation is protected rather than whether the obligation exists. The two analyses are difficult to separate. The Wisconsin Supreme Court in *Roth v. Glendale* adopted an analysis surprisingly similar to that of the *California League* court.<sup>156</sup> Rather than refusing to find a right to a benefit, as the *San Bernardino Public Employees' Ass'n* court did, in the absence of an explicit statutory provision or the like, the *Roth* court found a benefit, or in the language more used by the California courts, an obligation, which was vested (protected) because of the employees' legitimate expectations that their bargained for benefits would continue.<sup>157</sup> The court stated that the broader context in which benefits arose needed to be considered and that employees do not anticipate that retirement benefits will later be subject to future negotiations when they give up current wages for later retirement benefits.<sup>158</sup> The *Roth* analysis has been interpreted as holding that there is a presumption that the particular benefit is vested.<sup>159</sup> Other courts have protected obligations by finding that the public employer is estopped from denying benefits. In *Christensen v. Minneapolis Municipal Employees Retirement Board*, the Minnesota Supreme Court held that pension benefits could not be denied at retirement where employees showed reasonable reliance and enforcement was necessary to avoid injustice.<sup>160</sup>

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155. *San Bernardino Pub. Emps. Ass'n v. Fontana*, 79 Cal. Rptr. 2d 634, 638-39 (Ct. App. 1998); see also *supra* note 113 and accompanying text.

156. 614 N.W.2d 467, 472 (Wis. 2000).

157. *Id.*

158. *Id.*

159. See Sanchez, *supra* note 80, at 1172.

160. 331 N.W.2d 740, 749 (Minn. 1983); see also *Law Enforcement Labor Servs. v. Mower*, 469 N.W.2d 496, 501 (Minn. Ct. App. 1991), *rev'd on other grounds*, 483 N.W.2d 696 (Minn. 1992); Sanchez, *supra* note 80, at 1177.



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The rationales of legitimate expectation, such as in the *Roth*, and reasonable reliance, such as in *Christensen*, could have informed the California Supreme Court in its decision on the Ninth Circuit's certified question about an implied contract right in *Retired Employees Ass'n of Orange County*. In any event, the *California League* decision, as indicated previously, may likely cause governmental entities to negotiate contractual language more carefully to mitigate possible conflicting interpretations of contractual language.